The Interview – Philip Pirecki, Silverstone Capital: “Mispricing never goes away”

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Silverstone Capital partner Philip Pirecki says the firm’s eponymous fund, which invests across the automotive industry value chain, can provide investment institutions such as pension funds with the alpha and low correlation they seek to achieve a return profile that will meet their investment objectives.

GFM: What is the background to your company and fund?

PP: The Silverstone Fund aims to exploit a deep understanding of the automotive industry value chain to generate superior risk-adjusted returns through investments in equity and equity-linked products across the value chain – in other words, a fund that produces true alpha with low correlation from pure stock-picking. We happen to focus on the auto sector, which happens to offer plentiful opportunities.

Launched in July 2004, the fund is a Cayman-domiciled master-feeder structure managed by Silverstone Capital Management, a Cayman-based investment manager. The sub-investment manager, Silverstone Capital, is based in London and the investment advisor, Highview Research, is based in Tokyo. I am one of the three partners of Silverstone Capital, the others being portfolio manager Saul Rubin and Tokyo-based Takashi Ito.

GFM: Who are your key service providers?

PP: The fund’s administrator is Fortis Prime Fund Solutions in the Isle of Man and the prime brokers and custodians are Credit Suisse and Morgan Stanley International in London. The fund auditor is PricewaterhouseCoopers in the Isle of Man and our legal counsel is Ogier in Grand Cayman.

GFM: What is the profile of your client base?

PP: Our clients are split between funds of hedge funds, institutions and family offices in Asia, Europe and the US.

GFM: How would you assess the impact of the recent global financial crisis and economic downturn on your business?

PP: Since 2008 many funds of funds and hedge funds have had their reputations destroyed, tarnishing the entire industry, while the deleveraging process has reduced the volume of assets. We were not immune to these reductions, and raising capital to take advantage of the opportunities that we currently see is the most challenging issue we face.

GFM: What is your investment process and how do you generate ideas for your funds?

PP: Valuation sits at the heart of our approach, though we apply valuation metrics in a flexible, non-dogmatic fashion that recognises, for instance, that the way one might value the equity of Toyota is very different from the way one might value the equity of GM.

We have no particular structural style bias, but ideally the portfolio consists of investments with different drivers, whether value, growth, restructuring and recovery or mergers and acquisitions. Sentiment is used to time investments or to stay away from them – we do not invest alongside sentiment where there is no valuation driver to an investment.

GFM: What is your approach to managing risk?

PP: Generally speaking, it is disciplined adherence to documented fund parameters, with the goal being to pick the risks we want to run. While that can’t be achieved completely, we believe that the main risk within the portfolio is stock-specific risk – that is, idiosyncratic risk.

GFM: How has your recent performance compared with your expectations and track record?

PP: We have always aimed to generate consistently between 12 and 15 per cent annualised gross returns. Over the past six years we have hovered around the 12 per cent mark despite the very challenging period of the past three years.

GFM: What opportunities are you looking at right now?

PP: Mispricing never goes away. We continue to see many opportunities on both the long and short sides of the portfolio.

GFM: What events do you expect to see in your sector in the coming year?

PP: Technology changes and emerging markets are the two largest challenges facing the industry, and we believe these developments will have a positive effect on our portfolio.

GFM: How do you assess investors’ current expectations?

PP: That’s a question that we really can’t answer. But it appears that investors want Madoff-style returns (but without the fraud), superb performance (over the past six months), being an ‘in’ strategy and a low career risk brand name.

GFM: What differentiates you from other managers in your sector?

PP: As far as we are aware, we are the only automotive sector fund. And generating true alpha with low correlation remains a rare and sought-after trait.

GFM: How do you view the environment for fundraising over the coming 12 months?

PP: The big get bigger, so it’s a difficult environment for smaller funds. Investment is returning to hedge funds, but it is disproportionately being allocated to the largest and most established firms. Large distribution platforms and marketing departments do help in raising assets; but it would be a mistake to equate size with safety and assume that smaller funds lack operational sophistication.

With much of these allocations coming from pension funds, we see growing pressure to produce alpha-driven returns from niche hedge funds. Pension funds are seeing contributions decreasing and flat returns at best while liabilities are increasing. Consequently, we think there will be a need to invest more broadly in order to pursue a return profile that will meet their investment objectives.

More to the point, we see funds like ours offering what investors are ultimately looking for.

Investors need alpha, but also want to stick with big names, which is a conundrum. It will also take time for funds of funds to rebuild credibility, as investors really cannot do due diligence on hundreds of small funds.

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